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on the Rules of Origin in Economic Partnership Agreement regional negotiations

Impact assessment

on

Rules of origin for Textiles and Clothing sector

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Executive summary

This report has analyzed the current rules of origin and looked carefully at assessing the way forward. The analysis showed that the change of the current rule, i.e. double transformation, to single transformation (or equivalent added value threshold) for textiles and clothing can contribute to reach the objectives set by the EPAs in terms of development growth and jobs for ACP countries. On the contrary, the maintenance of a *status quo* or the use of high value added thresholds would not help achieve these objectives.

The textiles and clothing (T&C) sector is one of the few remaining industrial sectors with important tariff preferences on the European market provided that its originating status can be established. Account being taken of that T&C is a commodity sector can mean substantial cost advantage over third countries' competitors exports subject to MFN duty . Whenever such advantage is combined with export-processing zone treatment in the source country speeding up customs clearance and lowering down relevant compliance costs may prove to be a critical export driving force. However, these advantages can become useless and the preference margin worthless if the stringency of RoO does not allow the use of competitive supplying sources.

Notwithstanding the above, it is important to assess, irrespective of considerations for trade diversion or trade creation, to which degree given RoO can confer market access. This is particularly important for most of the ACP countries in which a higher uptake of preferences meaning increase in their exports has a positive impact on economic and social development, including job creation and poverty reduction, with important secondary effects on the local economy.

A liberalization of RoO is likely to increase competition on the EU market for some EU industries. However, EU imports in textiles and clothing from ACP countries are likely to compete more directly with other such countries' exports (e.g. China) rather than with EU production, which tends to be of higher quality and have the advantage of proximity in order to quickly adapt to fashion trends and to demand. Furthermore, the ACP countries are small producers of most industrial products, including textiles and clothing, have significant structural problems that limit their industrial development capacity, and will remain marginal on the EU market even if they would manage to substantially increase their supply capacity and exports to the EU. To the extent that ACP countries can develop their exports, EU industries that use imported inputs will gain from more liberal RoO reform due to access to cheaper inputs, while EU consumers will benefit from lower prices.

Introduction

For a long period of time discussions on rules of origin where confined to the margins of policy making and academia. They were limited to considerations of investment and local content and custom procedures. In its Green Paper (Com (2003) 787 final of 18/12/2003) the European Commission has acknowledged that the current rules do present limitations to LDCs to fully use their preferences. They do not any longer reflect the industrial reality in the European Union and they are complex to understand and implement. It is also acknowledged by the Commission that the level of complexity renders trade facilitation complex and the quality of control does often not match the complexity of the rules.

Rules of origin are the subject of intense and constant attention from the industry. Euratex (European Textiles and Clothing association) has a committee on preferential rules of origin since beginning 90's. In countries like Bangladesh, South Africa rules of origin are subject of intense debate between textile and clothing industries. Interest from NGO's into rules of origin and textiles is more recent, but they have certainly joined the debate. Most notable is the working paper of Oxfam[1].

Rules of Origin (RoO) need to ensure that ACP producers benefit from the EU market access offer. This implies clearly that RoO should in parallel, allow an increase of the ACP exporters to EU markets, and prevent circumvention, i.e. they must not simply become a transit channel for exports from third countries. The 6 ACP regions need simpler, more transparent and easier to apply Rules of Origin in order to ensure EPAs deliver the maximum benefit and the ACP can source inputs where they need them.

This report assesses the impact of a change in preferential rules of origin for textiles and clothing in the framework of the Commission's currently on-going negotiations for the Economic Partnership Agreements (EPA) with the ACP countries.

After a presentation of the current RoO applied to T&C sector, a focus is made to the single transformation criterion (or equivalent low added value threshold) in order to assess its applicability, weak and strong points. An analysis of the impact of such change on the ACP countries in terms of economic growth and creation of jobs with subsequent poverty reduction in particular for the ACP LDCs follows. With regard to the latter, a comparative analysis of the preference schemes applied by US, Canada and EU illustrates how much a relaxation of RoO in particular for the clothing sector can contribute to the development needs of these countries, *albeit* limited to a handful of countries.

Finally, in view of the expected increase in the ACP exports to EU market from a change in RoO for T&C sector, the impact on the EU industry is evaluated. As it will be shown, EU industry is not expected to suffer any material injury from an even substantial increase in the ACP exports to EU, given their remaining low market share (even if exports multiplied by a factor of three or four), and their likely direct competition with third countries' exports rather than with the EU local industry.

[1] Oxfam "Stitched Up", Briefing Paper no.60 April 2004

Waiver:

The present report commits only the Commission's services involved in the preparation of a proposal for the rules of origin for textiles and clothing in the framework of the currently on-going negotiation for the Economic Partnership Agreements with the ACP countries. The text is prepared as a basis for comment and does not prejudge the final form of any decision to be taken by the Commission at a later stage.

1. PROBLEM DEFINITION

Are the existing rules too severe?

Statistical considerations

The bulk of the EU's imports (170€ billion) from preference-eligible countries originate from non-ACP countries. ACP countries only account for 10% of the value of imports and the EBA countries only for 3.8% of the value of imports.

A detailed analysis of RoO and preferences at the tariff line level suggests that for up to one half of the tariff lines, preference rates are negligible[2]. Utilization rates are positively correlated with preferential margins, though the elasticity of utilization to increases in preferential margins is low: a doubling of the preferential margin from 5% to 10%, only raises utilization rates by 4-5 percentage points.

The ACP share of EU imports of Textiles and clothing is small (1.19%) showing thus the low performance of ACP exporters in this particular sector (compared to the China's share 37.82%). Two ACP countries dominate in both HS 61-63 and in HS 50-60, Mauritius and Madagascar. The exports of Mauritius are about twice those of Madagascar. Together they account for more than 90% of all EU imports of clothing from ACP countries (HS 61-63) and almost 80% of EU import of Textiles and clothing (HS 50-63).

Restrictiveness

Based on a study launched by DG DEV[2], it is estimated that the value added equivalent of current preferential rules for all the products correspond to 56%. This means that the change of the rules to a 56% VA would have a neutral effect, i.e. the stringency of the rules remains intact. However, the figure for the textiles and clothing sector is 85-90%.

The same study confirms that aggregating restrictiveness of tariff lines to those with a preference margin of at least 10%, one finds a very large dispersion in utilization rates for given preference margins, confirming the importance of RoO in determining preference uptake. The low utilization rates in the clothing sector combined with a stagnation of African clothing exports to the EU points thus to the restrictiveness of rules of origin in the T&C sector as one of its likely causes. Furthermore, this low rate opposed to the substantial increase of such exports to the US and Canada following the liberalization of their RoO, indicates that the potential benefits of EU preferential access in clothing for ACP countries have never materialized, partly as a result of too strict RoO

[2] Evaluating the consequences of shift to VA method for determining origin in EU PTAs; ADE (letter of contract N° 2005/103984), July 2006

- with the exception of Mauritius and Madagascar, which make almost 1 % of all EU imports of textiles and clothing.

The study constructs a categorical index ranging from 1 (least restrictive) to 7 (most restrictive) on the basis of the current rules. The index is conceptualized as an indicator of how demanding a given RoO is for an exporter. The resulting restrictiveness of the current rules gives a high value for T&C (6.19 out of 7), suggesting thus strict rules. In this connection, it is worth noting that values of the index are positively correlated with preferential margins suggesting that more restrictive RoO are indeed associated with higher preferential margins.

What should the RoO achieve?

In general, there is unanimity on that RoO must ensure that the preferences accrue to the intended beneficiaries, i.e. the ACP countries. However, the opinions are quite different on what is that the origin rules are intended to reach. All agree that a basic task of the origin rule is to avoid trade deflection, which would occur if producers in a third country were able to establish shell companies in the ACP countries that import almost fully finished goods and re-export them with minimal processing – solely in order to obtain the trade preference. The second task is to stimulate the creation of value in the ACP countries. Hence, the preference will be in practice available only for goods which incorporate domestic raw materials, or to countries that have a developed and competitive intermediate goods sector, or in cases where the preferential margin is sufficiently large to make it commercially feasible for a firm to undertake processes that otherwise it would not perform.

With regard to the latter, there are three principal characteristics influencing such decision of the firm:

- How easy it is for the firm to change its underlying production technology;
- How easy it is for the firm to source intermediates from domestic sources;
- How easy is for the firm to prove that its suppliers have originating products satisfying thus the requirements for its final product.

The response to the above questions could provide the right type of rules of origin to be applied.

2. OBJECTIVE

For ACP countries, the main challenge is very obviously to maintain current preferential market access opportunities in mainly the EU and the US, while at the same time increase them[3].

Rules of Origin must be used to ensure that ACP producers benefit from access to EU markets by enabling an increase of exports of goods manufactured in ACP countries. In parallel, they must not simply become a transit channel for exports from third countries.

[3] See See ACP – EU Council of Ministers Joint Report on Phase 1 of the negotiations for an EPA, ACP/00/118/03 Rev.1, ACP-EC/NG/NP/43, Brussels, 2 October 2003, paragraph 4(b)(iii).

The 6 ACP regions need simpler, more transparent and easier to apply Rules of Origin in order to ensure EPAs deliver the maximum benefit and the ACP can source inputs where they need them.

In the particular case of T&C, the low performance of ACP exporters to the EU indicates one single clear objective:

RoO generating a substantial increase of their exports of goods manufactured in ACP countries and preventing trade deflection.

3. POLICY OPTIONS AND THEIR ASSESSMENT

3.1. Policy option A: maintenance of the current rules

The current rule for T&C is basically the double transformation criterion. This rule stimulates the creation of value in the ACP countries by encouraging substantial processes to be undertaken. It promotes therefore vertical integration and production of intermediate inputs in the ACP regions.

The double transformation criterion underpins the EU preferential rules of origin in T&C. A combination of different rules (i.e. cumulation rules, which are the equivalent of a single transformation when sourcing in a regional area or with privileged partners; the territoriality clause, which is aimed at preventing fraud; and the tolerance rule, which enables the use of non-originating material up to a certain percentage)imply all together that most intermediate goods need to be of preferential origin. Therefore, the total effect of combined elements is that around 90% of value of input need to be of preferential origin, for those countries not having on its own the textile processing basis (very much lower in case of cumulation) apply to the majority of ACP countries that benefit from EU preferences.

However technological changes and global trade liberalisation have led to the fragmentation of production processes and the development of global sourcing networks. Strict rules of origin act to constrain the ability of firms to integrate into these global production networks and, as has happened, to dampen the location of any new value-added activities in the clothing sector. Rules of origin influence the nature of investments. Investments are calculated against a preference, while the nature of rules of origin (value, or specific processes) influences the type of investment.

The rules of origin as they currently exist have a clear technological bias. They confer great importance to spinning as they are largely yarn forward. While spinners have themselves free choice of raw materials (the origin of fibres does not influence the origin of yarns) all next stages in the supply chain are limited in their choices. Rules of origin are imagined in a mechanical world when spinning and weaving were the most valuable processes. As Scheffer has stated (2003)[4], it is increasingly the chemical processes that add value to textiles and clothing, such as dyeing, functional finishes, washing processes. The rules of origin are still based on a mechanical world wherein

[4] **Scheffer, M**. e.a. (2003) Potenties voor Beschermend Textiel. Ministerie van Economische Zaken. The Hague

mechanical processes confer value. Moreover as Scheffer (2006)[5] has assessed the immaterial side of clothing and textiles has an increasing share of value of transactions. Design, marketing, refined logistical arrangements, service costs such as keeping goods in stock for fast dispatching are dominating costs as compared to the strict manufacturing costs – although they are not elements that can be taken into account when determining the criteria that confer origin.

Current rules of origin do overlook that not only manufacturing conditions matter but also aspects of service and marketing. As Naumann (2005)[6] puts it: "*Strict origin rules make compliance onerous if not indeed impossible, especially for many developing countries with less developed infrastructure or domestic production capabilities. Likewise, with international trade and associated supporting logistics having rapidly developed in recent years, it is no longer sufficient for a country to be able to merely produce a given input. These have to be produced within a given competitive framework, incorporating efficient and competitive lead times, pricing, quantitative, qualitative and other characteristics*".

With regard to the developmental aspect of preferential rules of origin, Brenton[7] states rules of origin in textiles and clothing are based on the assumption that an export led national valorisation strategy is possible and that hence clothing production leads to backward integration in textiles. Brenton states the EU rules of origin "*are often supported by the argument that they are necessary to encourage substantial value-added activities in developing countries and as a mechanism for encouraging the development of integrated production structures within individual developing countries, or within regional groups of countries through cumulation mechanisms, to maximize the impact on employment and to ensure that it is not just low value-added activities that are undertaken in the developing countries (…). Such rules discriminate against small countries where the possibilities for local sourcing are limited or non-existent. Since most developing countries are small countries they are particularly disadvantaged by restrictive rules of origin relative to larger countries. Second, there is no evidence that strict rules of origin over the past 30 years have done anything to stimulate the development of integrated production structures in developing countries"* (Brenton & Ozden, 2005).

This implies that rules of origin are designed to underpin a strategy of export valorisation through substitution of imports of intermediates. As far as small countries are concerned, Brenton's argument seems valid. Tunisia and Sri Lanka have attempted in the 1960's to favour backward integration by setting up import levies and fostering a planned expansion of textile industries. In both cases the model has failed. The companies set up did often not reach quality and price levels required in global markets, behaved as monopolists and lacked profit orientation, and often concentrated then on captive local markets (uniforms, institutional markets). In both Tunisia and Sri Lanka the state controlled sector collapsed in the 1980's. In India, Pakistan, China and Turkey

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[5] **Scheffer, M.** (2006) Technological Change, Fashion and Globalization. The imperative of Cycles of Capital. Paper presented at CUNY, New York March 9th. Forthcoming as a chapter in a book E.Paulicelli ed.

[6] **Naumann, E.** (2005) Rules of Origin under EPAs: Key Issues and New Directions, Paper for Tralac Conference October 2005.

[7] **Brenton,. P. and C. Ozden** (2005) Trade preferences for apparel and the role of rules of origin – the case of Africa. Working Paper PREM Trade DECRG, The World Bank, Washington.

the policies of import substitution worked better, because of a larger local market, stronger endowment in factors and a more sustained but gradual phase out of government support. It should be noted that regional cumulation may sometimes alleviate the argument of Brenton, as may the case with the European cumulation systems.

3.1.1. Could cumulation solve the problem?

The ACP Cumulation has not as yet had significant positive effects.

The transformation of a principle of double transformation with wide cumulation between complementary economies compensates for different endowments, as long as no further barriers are set in the repartition between value added amongst countries with a cumulation. This is then an important element to take into account in further scenario development.

The SADC cumulation rules are designed to combine South Africa's textile base with lower cost for clothing assembly in other member states but they are not extended to the ACP system. Therefore, an extension of ACP + SAF may offer a regional complementarity, but as Flatters (2005) states the South African textile industry is not competitive in design, quality and flexibility compared to the EU and not competitive in price compared to Asian suppliers. A regional cumulation thus contributes little to expansion of exports to the EU, nor too little regional integration.

An ODI study[8] analyzed the alternative to address the feature of poor countries economically small by providing flexible rules on cumulation, so that firms in several countries can contribute to achievement of the required high value added implied by the current rules. For this alternative to be feasible, some of these countries would need to be competitive exporters of intermediates that could be used by other of them in the production of a final good. The evidence analysed by this study suggests that these countries are exporting competitive and not complementary goods to the EU. Permitting cumulation with other competitive countries with which vertical integration could be possible as Turkey or other pan-Euro-Mediterranean countries would give a real advantage to these countries, but it would be relatively burdensome to administer yet provided that required administrative co-operation between these countries is established

The above should be seen in conjunction with the lack of capital and poor infrastructure in the ACP countries. Competitiveness and availability of raw materials depend on a number of factors having to do with marketing, management capacity, matching of demand and supply and transport costs, to name some of them. This leads us to the questions raised under section 1 above: given the preferential margin, are there real opportunities for producers to undertake processes that otherwise it would not perform? On the basis of the above, it seems clear that this is not the case. The experience from the current RoO poor results demonstrates this.

[8] "Creating development friendly rules of origin in the UE"; Overseas Development Institute (ODI), Nov. 2006

3.1.2. Duty drawback issue

Many developing countries employ drawback in order to attract investment and to encourage exports. Drawback in the context of a preferential agreement is viewed as providing a cost advantage to the producers based in the partner countries who gear their final goods to export over producers selling their final goods in the domestic market.

Many preferential trade agreements prohibit duty drawback – preclude the refunding of tariffs on non-originating inputs that are subsequently included in a final product that is exported to a preferential partner. The end of duty drawback entails an increase in the cost of non-originating components for final goods producers. As such the end of drawback prohibition may encourage producers to shift to suppliers in the cumulation area.

In the Cotonou agreement, there is however no specific provision on that matter, i.e. every ACP country can use duty drawback or not irrespective of whether the importing inputs are originating or not. In this context, account being taken of the high import duties applied in most of the ACP countries and the lack of customs union between them, it is not surprising that cumulation has not been at all successful while strict RoO were supposed to favour it.

3.2. Policy option B: using a VA threshold

In order to have a more comprehensive and complete picture on the potential implications of a Value Added criterion, two main alternative scenarios are presented with respectively two different threshold of Value Added: 1) a high VA scenario, 70%, and 2) a low VA scenario, 50%.

Two main patterns are interesting to follow, in order to show the impacts of these two different scenarios. As elaborated in the Scheffer' Study, in a first stance we will look at three key-different stages in the Textile and Clothing process while in a second stance we will instead look at the impact of these two different thresholds on EU Imports and Trade Flows[9].

3.2.1. 70% Vale added Criterion

a) Its impact on the three main processes stages for T&C production is the following:

<u>*Yarns*</u>: By assuming an average value around 55% in the Ex-Work Price (EXW), the 70% threshold will be, ceteris paribus, not reachable for most of yarns unless the fibers are wholly obtained or very substantial processing is carried out. Only countries with a fibre base would be able to qualify for it.

<u>*Fabrics*</u>: Here the average value is computed around 65% (EXW). In turns this means that at the fabric formation stage, very few fabrics, especially in LDC's, would reach the threshold here assumed, since it requires a very well integrated chain.

[9] M. Scheffer, "*Study on the Application of Value Criteria for Textile Products in Preferential Rules of Origin*", Tender 06-H13, 2006 p. 47

Garments: For Garments (Chapters 61, 63) average value is around 65% (EXW). With a 70% threshold very few products would qualify for preferential origin only through making-up. This threshold would be indeed achievable mostly where a process of washing and garment dyeing is added. Therefore, a 70% criterion translates in a modernized *double transformation*. For least developed countries the 70% level is only double transformation for half the product types. For the other half, mainly simple made up products with lower labour content it coincides with triple transformation[10].

b) Now, considering the EU Trade Flows and Imports impacts:

By looking at EU Imports, these will be marginally increased. Indeed, the EU will increase its imports respectively of 0.07% in textile and 0.48% in clothing.

Always looking to potential changes in EU imports, it is also noted a relative small change at the intra-trade level of textiles and clothing among EU countries. A limited decrease in imports from EU textiles producers of 1.11% would occur, while a decrease of 1.40% in clothing, due mostly to the entry of third countries products into the EU. Trade flows diverted/created in this scenario were estimated to be around Euro 500 million, which represent only the 1% of the entire imports for Textiles and Clothing.[11]

3.2.2. 50% Value Added Scenario

a) By assuming a 50% VA scenario, as in the previous assessment, a focus firstly on the three main T&C stages gives the following:

Yarn: With an average value of 55% (EXW), it will be however mostly complex yarns (twined, twisted, texturised, dyed and finished) which will obtain the preferential status.

Fabrics: Even with a 50% threshold of Value added just a small majority of fabric types will qualify for preferential origin. In particular,, there would be still a need to combine mechanical and chemical processes (spinning and weaving usually confer origin as well).

Garments: In garments (Chapters 61, 63) the average value added is around 65%. However, simple making it usually does not confer origin unless trimmings and additional processes are undertaken. Therefore even with a threshold of 50%, an additional process is required in order to grant origin. For the least developing countries the 50% is attainable only for a minority of products, especially as they have a limited trimmings supply basis. For them a 50% threshold is a continuation of a double transformation. Even 35% is a difficult target.

b) Now, considering the EU Trade Flows and Imports impacts.

Total Imports will increase of 0.16% for Textiles while they would substantially increase in clothing: almost the 1%. This would mean a total estimated increase of roughly 600 million Euro.

[10] *Ibidem* p.46

[11] *Ibidem* p.60

Coming to the potential changes in Imports of Textile and Clothing of the EU, the impact even in this scenario is going to be relatively small. Trade flows diverted/created would be around 900 million which represent less than the 2%.

3.2.3. Conclusions on the two VA scenarios

Overall, the results mostly highlighted through these two scenarios show that, especially for ACP LDCs countries, both 50 or 70% threshold would not make any substantial change to the present situation. Indeed, as Scheffer argues, in both cases the Value Added threshold is too high to give a substantial improvement for preferential access. The Value Criterion favors countries for example with a fibre base. This is rarely the case of LDCs. More in particular, in the case of Yarn, just spinning it does not arrive to add by itself more than the 40%, unless the fibres are wholly obtained. Fabrics also confer origin mostly trough chemical process which is quite difficult for an LDC country to provide. Finally, for Garments, products may reach a 50% or higher thresholds only through making-up. However, this implies having a well integrated vertical industry which for most LDCs and especially African ones is currently unrealistic. Based on that, in general a value criterion favors the final stages of production.

Finally, additional evidence to these patterns and trends is provided from the experience of Lesotho[12]. In this context, Garments prices from Lesotho are 8 to 14% higher than China when fabric and trims are sourced locally but also regionally. This is of course due to the geographical characteristics of Lesotho which, as many other African LDCs, is landlocked and therefore pays high costs to reach shipping ports and in turn northern Europe. To give an example the production of *simple jeans* reaches a maximum value on EXW of 29-35%. Washed products may reach the 40%. In any case, none of the commercial products in Lesotho reach a 50% threshold.

From the above, it appears that solely a substantially low VA threshold (25-35%) could have a positive impact in terms of increase in exports and subsequent development, as this will be shown in the next section, where a single transformation criterion (equivalent to a low VA threshold) is analyzed.]

3.3. Policy option C: using a single transformation criterion [(equivalent low VA threshold)]

Many NGOs favour the establishment of a single transformation rule and/or a low value criterion at 25%, as if its simplicity and limited investment required favours industrialisation in LDC's. The AGOA is a favourable argument for a relaxation of origin requirements, the Canadian Policy of Market Access Improvement for LDC's is used by Oxfam as a good example with its 25% value added criterion (when the inputs are originating in other GSP countries). In that case LDCs benefiting from more generous rules of origin may benefit from trade diversion at the expense of more developed countries with more restrictive rules. This seems to be applicable in the particular case of T&C sector.

[12] *Ibidem*, p 76

3.3.1. Trade deflection versus trade diversion

Preferential rules of origin aim at preventing trade deflection, i.e. to enable countries to channel intermediates or end products via launch pads in order to gain preferences. Trade deflection would limit activities to a strict minimum in order to benefit of certain trade regimes. However, trade deflection should not be confused with trade diversion. The latter would imply that new industries are being set up because of a definition of rules of origin that foster industrialization.

The argument of trade deflection does not lead automatically to a principle of double transformation. Even in a single transformation rule, the current principle is clear that full making up must occur and simple operations (finishing hems of sleeves, labelling and button setting etc…) are excluded. However full making up, that represents at least 25% of the value of the garment, is not currently considered as a sufficient transformation and leading to substantial industrialization. This trade diversion would be at the expense of direct exports to the EU market from main suppliers such as China.

Some countries have developed an endogenous garment industry despite unfavourable origin rules, like e.g. Sri Lanka, Bangladesh and Mauritius. The first two countries have long benefited from a price advantage even with MFN duties and less restrictive or no quota, while Mauritius has industrialized around knitwear and has benefited from its preferential status.

As previously mentioned, RoO should prevent trade deflection. The commercial viability of trade deflection depends on the relative height of tariffs in the EU and the preference receiving state. Trade deflection only matters, therefore, when the tariff levied by the preference receiving country is lower than the tariff of the EU, i.e. the MFN duty. In addition, sufficient infrastructure in ports is a *sine qua non* condition for the third countries exporters to transship their products through ACP countries before they enter the EU market. This latter requirement led us to distinguish the following ACP countries (within brackets the harbor with adequate facilities):

- In the East side of Africa: Kenya (Mombasa), Tanzania (Dar-es-Salam), Mozambique (Maputo also entering point to SA, Beira), SA (Durban also entering point to Lesotho), and Mauritius;

- In the West side of Africa: Cameroon (Douala), Nigeria (Lagos), Benin (Cotonou also entering point to Nigeria), Ghana (Accra), Senegal (Dakar) and Côte d'Ivoire (Abidjan).

In view of the fact that major players/competitors in the international trade of T&C sector are China, India and Pakistan, considerable transport costs would be incurred for shipping the products to the West Africa. Therefore, solely East Africa entering points were considered. The respective importing countries were found to apply tariffs higher than the EU's MFN duty, with the exception of Mauritius which applies mainly 0% duty (except parts of chapters 57-59 and 63). From the above, one can easily conclude that the conditions for trade deflection in most of cases can not be met, except in case drawbacks apply.

3.3.2. Availability of Textiles in Africa

The study Scheffer confirms that availability of textiles in Africa is often problematic. This has to do with marketing and sourcing abilities of management, decision power on

suppliers that is external to the region, mismatch between supply and demand, lack of reactivity and transport costs and times.

The African markets are extremely complex because of ethnic diversity, and dominance of informal trade patterns. Development of textile production is further hampered by lack of capital and poor infrastructure. Those who invest try to protect their investment by promoting barriers to import, and do so also restrict the creation of regional markets. RoO that in theory enable regional integration have not done so as yet. Nevertheless regarding the strong and good cotton base Africa has a potential. The conditions are a preferential margin compared to dominant suppliers and the fostering of regional integration.

Despite a strong growing base vertical integration into spinning and weaving has been limited. Ginned cotton has first chiefly been exported to Europe and now to China. Textile industrialisation has mainly been set up by European firms or in joint ventures in order to supply local markets. Quality and service levels are not at current standards required by global buyers. Political instability has hampered the establishment of stable investments. Moreover the African market is dominated by European imports for high end products (e.g. Dutch Wax), second hand clothing for the masses and increasingly Chinese imports.

The limit to current rules of origin is the paucity of local fabric supply. Research confirms that in volume terms textile supply is limited.

Vertical integration and regional integration has recently become an issue in Lesotho. Not only because of EU rules of origin but also because of cost advantages and more important lead times and quality factors.

Under section "analysis of impacts", two cases of reform of origin rules in respect of preferential schemes are analysed. They provide valuable input relating to the impact on job creation and economic growth. The USA has introduced in the AGOA act a temporary single transformation rule. In Canada the Market Access Initiative for LDC's entails for LDC duty free access with a low value added criterion (25%) and a GSP – wide cumulation zone.

4. ANALYSIS OF IMPACTS

4.1. Impact on economic growth and jobs for ACP countries

4.1.1. Comparison of the policy options

Policy A as explained above present significant limitations, as the rule of double transformation favours vertical integrated production, which is not any more adapted to the forces of globalization having evidently driven manufacturing companies to buy raw materials from the cheapest available source in order to keep being competitive and selling more finished products internationally.

[Policy B would not make any substantial change to the present situation, as in both scenarios the Value Added threshold is too high to give a substantial improvement for preferential access.]

Policy C seems to offer the best alternative as the most development-friendly for ACP countries, by generating a substantial increase in exports (of goods manufactured in

ACP). Studies have found that sufficiently relaxed RoO, as it is considered to be the single transformation criterion for T&C, could be an important driving force behind an increase in exports from developing countries (even if the added local value is low) and have significant economic and social impacts, including job creation and poverty reduction, with important secondary effects on the local economy, which must not be overlooked. This reasoning applies to the T&C sector, but appears to be particularly relevant to the labour intensive clothing industry. In fact, for countries with little capital, the development of e.g. the clothing industry represents one of the few potential avenues for industrialization.

4.1.2. Analysis of other models

Assessing the impact of real policies is the most effective way to examine the potential impacts of policy change on trade. The following is a presentation of two other models applied by two major donors, i.e. US and Canada, in the T&C sector. Factual elements showing the efficiency of these models re T&C as a development tool for the African LDCs[13] will be analysed and their case will be used as a reference to the evaluation of the single transformation rule presented above.

- AGOA

The AGOA system, fully named as African Growth and Opportunity Act, is a system of temporary custom duty relief granted by and for importation into the USA introduced in 2000. It has three main features: 1) it grants total duty relief, 2) it has a double transformation origin rule with diagonal AGOA cumulation, and 3) it is a temporary relief system of the double transformation for the least developed sub Saharan countries.

It extends the product coverage of the US GSP, particularly in the field of textiles and clothing, by adding some 1800 products to the regular GSP product coverage. About two-thirds of the AGOA beneficiaries are subject to so-called apparel eligibility, qualifying their exports for duty-free and quota-free treatment for eligible articles (i.e. allowing cumulation within eligible countries or with the US) until 2015.[14] This access is subject to a cap.

Under a Special Rule for Apparel for lesser-developed beneficiary countries, those with a per capita GNP under $1,500 in 1998 (note that this is not the same as the LDC definition of the UN), enjoy an additional preference in the form of duty-free access for apparel made from fabric originating anywhere in the world (this is known as the third country fabric provision). The Special Rule is in effect for a certain period of time and subject to a cap.[15] Clothing assembled from non-U.S. fabrics is subject to quantitative restrictions. Within this there is a sub-limit on imports under the special rule of origin

[13] In order to make a comparative analysis between the different models, the African LDCs were solely considered. Given that Africa account 36 LDCs out of 40 in ACP LDCs and 76 ACP countries in total, the conclusions drawn from their analysis are important for the purpose of the present report.

[14] More than 900 tariff lines for manufactured products such as textiles and leather products are not covered by AGOA. The average duty on these excluded products is around 9 percent.

[15] Botswana and Namibia have been exceptionally included since AGOA II in 2002. Mauritius also qualifies for the special rule under an exception since 2004. A cap of 5% of the total US imports under the Special rule applies to Mauritius.

which allows for global sourcing of fabrics up to a certain percentage of total U.S. clothing imports[16].

-Canada's Market Access Initiative for LDC's

Canada decided in 2003 to launch the so called Market Access Initiative for LDCs. A particular objective was to grant specific advantages for import of textiles and clothing. The regime is relevant for least developed countries like Bangladesh, Cambodia and Laos in Asia, and has the same coverage as AGOA and ACP for Africa. A salient feature is the introduction of a value criterion of 25% added value (ex – works) as a substantial transformation level, provided that materials are originating from a GPT country. China is considered as a GPT country.

4.1.3. Comparative analysis between EU, US and Canadian models for clothing

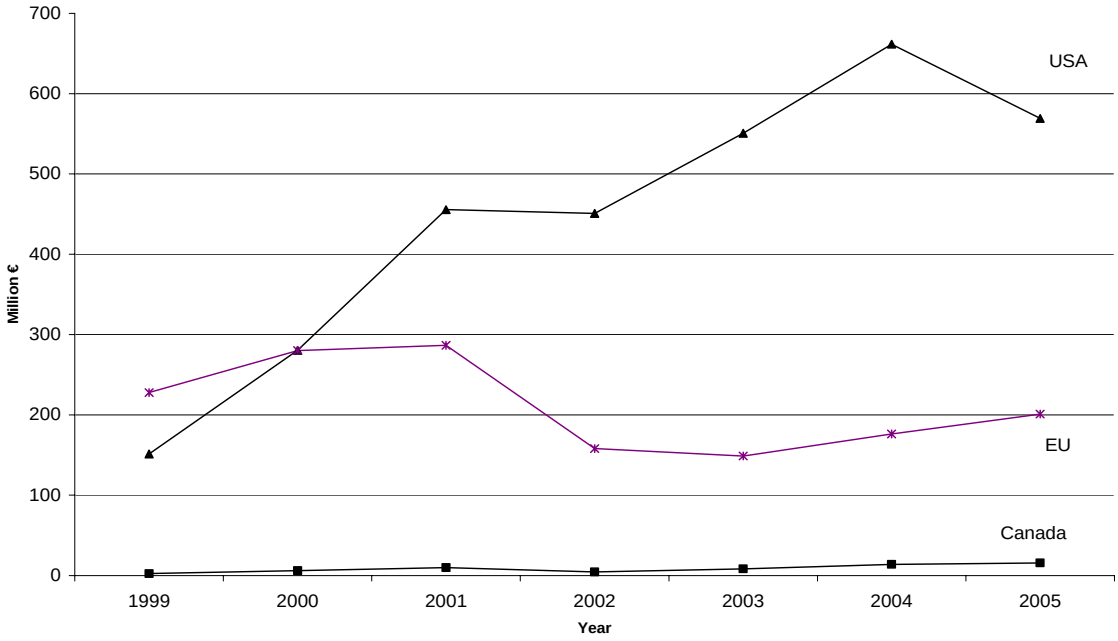
The specific case of clothing has received a lot of attention in analyses of the impact of AGOA. In addition, in our own analysis of preference use, we find low utilisation rates in the sector for several LDCs, especially in HS 62 – non-knitted clothing. We therefore looked in particular at this sub-sector to see the extent to which it displays different characteristics to that of trade in general.

EU, US and Canadian imports of clothing (HS61-63) from African LDCs are shown in Figure 1. Interestingly, in this sub-sector the US imports almost four times more than the EU and Canada together. Note that in the US level of imports were lower than the EU's in 1999 and at the same level in 2000 before taking off and leaving the EU behind. The increase in US imports was particularly strong between 1999 and 2001 and between 2002 and 2004. The US rate of annual average growth reaches 12.5% over the study period, although from a very low starting point (imports of some 150 M USD). The last year shows a minor reduction in US imports, which is likely to be due to the restructuring of global sourcing patterns following the phase out of the textiles quotas. Indeed the textiles quotas are important to understanding the motivation for sourcing in Africa. Their disappearance poses problems for key African suppliers, in spite of their substantial preferences. This suggests that trying to set up a textile industry on the sole comparative advantage of tariff preferences might not work as others important factors limit the industry development.

The EU level of T&C imports from African LDCs is actually lower in 2005 than in 1999 (corresponding to an annual average growth of minus 1.8%). Exports fell between 2001 and 2002, but have otherwise not changed much over the period, not even after the abolition of textile quotas in 2005. Canada's imports from African LDCs have continuously increased since 1999 (close to 30% annual average growth over the period), but they remain far lower than EU and US levels. This is unsurprising given the relative size of their economy ($905bn in 2004, compared to $12.2 trillion for the US).

Figure 1: EU, US and Canadian imports from African LDCs in T&C (HS61-63), 1999-2005 (€ million)

[16] In reality these quota limits have never acted as a block to exports as they are never filled, especially that related to regional cumulation, which has utilisation rates close to 3%.



Source: EUROSTAT (Comext, Statistical regime 4), USITC and Statistics Canada

Part of the explanation for such rapid increases in exports to US could be differences in the level of protection. In other words, a relatively higher preferential margin provided by AGOA compared to EU preferences would be one motivating factor behind the rapid growth. To see the extent to which there are differences in preference margins we looked at applied MFN duties in the sector.

For the EU this is relatively straightforward as most duties in sector 62 and 63 are 12% . Canada's tariffs are also fairly consistently 18% across 61 and 62 . For the US it is much more complex, as duties vary widely and go up to 30%. The top five clothing exports under AGOA in 2005 and the MFN duties applied were women's cotton pullovers (16.5%), men's cotton pullovers (16.5%), woman's cotton trousers (16.6%), men's jeans (16.6%) and women's jeans (16.6%). Thus, although the motivation for using AGOA and Canadian preferences is slightly higher than that for using the EU's, the difference is not substantial, at least in the lines where African LDCs export.

As for the Canadian initiative, it is hailed as an example by OXFAM for the EU. Its positive impact in terms of increase in exports and subsequent development has nevertheless been limited to Lesotho with growing exports , albeit much lower than to the USA. Madagascar has also growing exports but also lower than to the EU or USA.

In order to further examine the issue of beneficial countries, the African LDCs exporting clothing to the EU, US and Canada are identified. Table 1 indicates that there is a strong concentration in the sector, with the vast majority of exports emanating from only a handful of countries. Madagascar is the most important African LDC exporter to the EU market and is number two on the two other markets. Lesotho dominates US and Canadian markets accounting for more than 55% of their respective T&C imports from African LDCs. Ethiopian and Cape Verde exports to the EU and Malawi's exports to the US are marginal in perspective.

Table 1: African LDCs accounting for more than 95% of T&C imports from all African LDCs on respective markets, 2005 (%)

	Share of T&C imports in 2005		
Country	EU	US	Canada
Madagascar	91.0	39.1	38.0
Ethiopia	2.5		
Cape Verde	2.1		
Lesotho		55.2	59.4
Malawi		3.2	

Source: TRADE/A/2 calculations

A key question raised on the basis of the table above is why are clothing exports concentrated to so few countries? One potential explanation is differences in preferential treatment between the different sectors and countries. The table below summarizes the differences in EU, US and Canada preferences for African LDCs in T&C:

Table 2: Summary of EU Cotonou, and US and Canada preferences for African LDCs in T&C

Aspect	**EU**	**Canada**	**USA**
1. Main scheme(s)	Cotonou	LDCT	AGOA
3. Geographical coverage	All	All	All countries defined as 'lesser developed'
4. T&C covered	Yes	As of 2003	Yes as of 2000
5. Depth of preferences	Duty- and quota-free	Duty- and quota-free	Duty- and quota-free
6. RoO - type	Double transformation	Double transformation	Third country fabric provision for certain LDCs
7. RoO - cumulation	Full ACP, OCT, EU Diagonal with South Africa, neighbouring countries	Full LDCT, and Canada GPT (including China): Limited up to 75% of the final value	SADC [d], WAEMU + extra cumulation for certain countries for clothing
8. Legal basis	Contractual	Autonomous	Autonomous
9. Political conditionality	Low	Low	High
10. Expiry	2008	2014	2008

From the above, it appears clear that the main difference between the preference schemes of the three importing countries is in relation to the rules of origin. It seems likely, therefore, that this factor contributes to the differences in trade outcomes.

Nevertheless, there could be other factors at work, beyond preferential treatment and RoO alone, which could explain, in particular, the concentration of benefits in certain countries. One study indicated that language barriers were holding back exports from Francophone African countries to the US market[17]. Although language may be part of the explanation, a more likely factor is that certain countries benefit from high levels of Asian FDI which are the basis for their export oriented clothing sector. For example, in Lesotho 90% of the clothing industry is controlled by South East Asians.

[17] Brenton and Ozden (2005)

4.2. Conclusions on rules of origin regarding textiles and clothing exports and economic development

The RoO under the Cotonou require that knitwear be manufactured from yarn 'cut to form or obtained directly to form' or fibre while non-knitted clothing should generally be manufactured from yarn (double transformation). For Cotonou, cumulation is allowed within all ACP, OCT, South Africa, EU and neighbouring countries.

We have seen from the above analysis that both the US and Canadian RoO are more liberal for African LDCs in the clothing sector than the EU. In effect both allow the provision of third country fabric which enables the African LDCs to source their inputs from anywhere in the world and still benefit from preferential access. Looking at the trade data in the light of this observation it is difficult not to conclude that liberal RoO have been the main driving force behind the African LDCs increased exports especially to the US. It is also clear that the EU RoO have not served to stimulate exports from the region. On the contrary exports in clothing have stagnated in recent years.

The AGOA system has had a major impact for apparel industrialisation in countries like Madagascar and Lesotho. The export level developed by AGOA countries to the US is substantial, at a level of € 1,2 billion for clothing while the exports to the EU are below € 0,7 billion. If one excludes Mauritius the ration is € 1,0 billion against € 0,3 billion. Exports of Kenya, Lesotho and Swaziland to the USA are together more than € 720 million, whereas the level to the EU is below € 10 Million.

The AGOA system has indeed enabled substantial use of fabrics of South East Asian and Chinese origin: 85% of imports are based on non-origination fabrics. This figure is above 95% for all countries but Mauritius and South-Africa. It has also led Taiwanese, Hong Kong China and Korean groups to set up factories in countries such as Lesotho. Madagascar has had more of a Mauritian led industrialisation. The trade effect on US imports is however small. The main effect is a trade diversion from China and SAARC countries to the AGOA ones.

In the Lesotho Case, AGOA has led to a type of industrialisation with foreign ownership being qualified as neo-fordist, that is factories based on simple machines, a refined division of labour and hence the mobilisation of unskilled workers, trained to perform effectively simple operations under foreign supervision. These factories are sometimes considered as night shifting factories, easily installable and easily removable. In terms of trade effects the AGOA system has two impacts: a trade diversion from Asia to Africa in terms of origin and from EU to USA in terms of destination. There is no vertical integration, not even in a regional setting. However the industrialisation has a direct employment impact especially on women employment, and any industrialisation has to start with labour intensive processes, as there are few other local advantages.

The AGOA system proves that a simple system based on suspension of duties and in effect a single transformation rule of origin has a sizeable impact in creating a head start for industrialisation in least developed countries. The conclusion is then justified that a single transformation rule or a value criteria with a similar effect is beneficial to the least developed countries. The nature of industrialisation is however constrained by the temporary nature of the AGOA regime and the dependence of these countries of external capital, competences and market access in order to set up industrialisation. The latter factor will however be valid anyhow, independently of the nature of the trade regime. The former factor does however reinforce the vulnerable and dependable nature of

industrialisation. One can only speculate on the impact on industrialisation in the long term if a more durable trade system is applied.

Given that the third country fabric provision by definition implies that large amounts of the value added in the clothing sector will come from outside the benefiting African LDC it is legitimate to pose the question of whether real benefits are obtained from these increased exports. As small amounts of value added are kept in the African LDC it could be argued that most of the benefits of AGOA, for example, have been captured by non-African LDC textile exporters. It is also true that in most African LDCs with large export sectors, the majority of clothing factories are foreign owned – usually by Asian companies. Thus Asian capital is certainly benefiting from preferential access schemes for the region, further increasing the perception of minimal benefits to the local economy.

However, studies that have looked at the impact of increased clothing industry activity on African LDCs have generally concluded that the impact in terms of employment and economic activity in general is significant and positive.[18] In particular they find that the impact increased exports have on employment and the secondary effects this employment has on the local economy should not be overlooked. Clothing is a highly labour intensive industry thus, contrary to the textiles sector, which is capital intensive, most of the value added in the sector consists of labour inputs and subsequent remuneration. The effects of increased exports on employment have been significant, especially in Lesotho and Madagascar. A recent study in Madagascar found that 94% of the 115,000 jobs in Export Processing Zones (EPZs) were in the textiles and clothing sector.[19]

In Lesotho, employment in the clothing sector increased by 50% in the first year of AGOA (2001) and more than doubled between 2000 and 2004. A study for the government of Lesotho found that the majority of employees in the sector are migrant workers sending large amounts of their salaries back to the poorer regions of the country and half support at least one dependent and some up to nine. The consultants concluded '*No other sector offers the same opportunities for stimulating growth, increasing employment and promoting technology transfers*'[20].

The fact is that in countries with low levels of capital and expertise the clothing industry represents one of the few potential avenues for industrialisation. Studies which have looked at the sector find important impacts in terms of skills acquisition which can be transferred to other industry as industrialisation develops.

Furthermore, there is no evidence that restrictive rules of origin have stimulated the development of indigenous textiles industries over the years. As one recent study pointed

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[18] Stevens and Keenan at IDS did an in-depth study of the impact of different preference schemes on Africa, including various case studies. They conclude that clothing factories provide good quality employment and training, often being the main or sole manufacturing activity in affected countries

[19] Maminirinarivo, R (2006) The Textiles and clothing industry of Madagascar, in Jauch, H and Traub-Merz, R , The Future of the Textiles and Clothing Industry in Sub-Saharan Africa, Bonn, Friedrich-Ebert-Stiftung

[20] Salm, et al (2002) Lesotho Garment Industry sub-sector study for the Government of Lesotho, Funded by DFID.

out, if even South Africa, the most developed country in the region, has not managed to develop an internationally competitive textile industry, it requires a considerable leap of faith to believe that such industries could be developed in other parts of Africa[21]. As a result of this fact, cumulation within the region is of little value to African LDCs. We see in AGOA that special quota provided for regional cumulation is almost untouched (around 3% utilisation), bearing witness to the fact that, given the choice, third country fabric is by far more competitive. This is in line with the conclusions of an ODI study (see section 3.1 above) that LDCs are exporting competitive and not complementary goods to the EU.

Clearly, the introduction of simple transformation would reduce the chances of developing an indigenous textile industry in the ACP countries and this factor needs to be considered in the choice on rules of origin. In effect a choice for simple transformation against double transformation amounts to a policy which encourages the development of the (labour intensive) clothing industry at the expense of the (capital and technology intensive) textiles industry.

Of course, as the AGOA experience has demonstrated, not all of the ACP countries will be in a position to grasp this opportunity. Trade preferences and RoO are not the only factor driving exports. Issues such as supply capacity, business climate, governance, infrastructure and logistics play a major role.

For countries with an existing or potential textiles industry this may not be viewed as a development friendly choice. In Africa, however, little indigenous industry exists and there seems to be little prospect of such a development in the medium term. If development policy is to favour job creation, simple transformation certainly seems to be one way of stimulating new jobs in the clothing sector.

Finally, there may be a need for nuanced approaches to this issue as countries differ in their development needs. Some non ACP LDCs have developed domestic textiles industries. Bangladesh is a good example. There the government has had great difficulty in establishing a clear policy on rules of origin because of the competing needs of the domestic textiles and clothing sectors[22]. In addition, the cotton producing regions, like West Africa, may consider that their medium-term potential to develop an indigenous textile industry outweighs the short term potential to develop an export oriented clothing industry. Within the context of the EPAs, flexibility on this issue could also be shown.

4.3. Impact on EU industry

It is worth recalling that textile has always been a significant sector in the world trade both for developed and developing countries alike. According to WTO estimates, in 2005, world exports of T&C amounted to €382 billion, 5% of total world exports. The EU is the world's second largest exporter of textile products in 2005, with EU-25 exports accounting for a 16% share of world textile exports, and the world's second largest exporter of T&C accounting for a 12,4% share.

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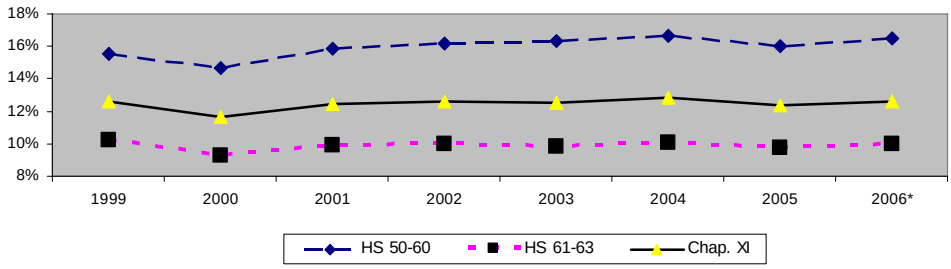
[21] Stevens and Keenan (2004)

[22] However the low level of competitiveness of the indigenous industry is illustrated by the fact that only 25% of their exports of woven clothing to the EU received preferences in 2005. The rest paid MFN tariffs, most likely because it is cheaper to do so than to use domestic fabrics and qualify for preferences.

When the quotas on textiles and clothing were phased out in 2005, the main effect was that China and India gained substantial shares of the EU market in these products, while other developing countries, especially in Asia, lost out.

However, one interesting view is that within the EU, an apparent stabilisation level has been reached in which firms engaged in highly sophisticated textile production, whether in aesthetic or technical terms have not only been able to adapt and survive but to maintain their export market shares, as the figure 5.4.1 below shows.

Figure 5.4.1: EU export World market share (%) for textiles and clothing

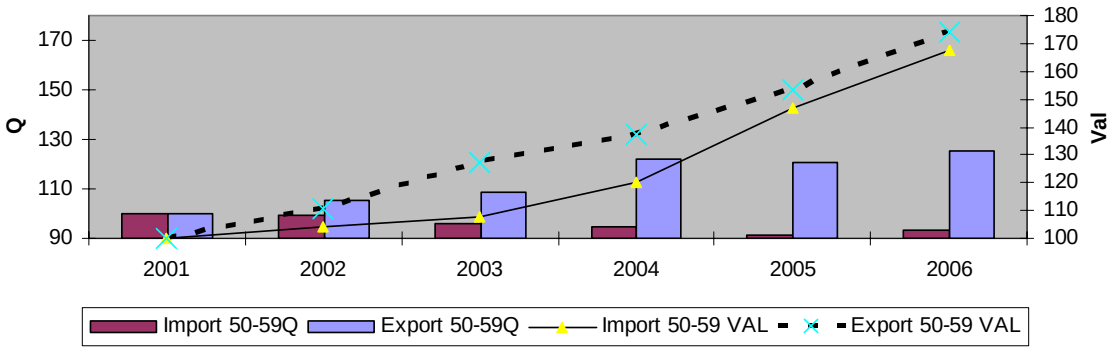


If we look at the exported and imported quantities and values of textiles in the period 1999-2006, the following is shown:

- import prices increased substantially (increased value against decreased quantity, i.e. 5,3% increase in weighted average price) indicating the competition with the EU high quality (thus expensive) textile products. Euratex[23] confirms that "*import prices increased quite rapidly: +5% for textile and +2,3% for clothing*". More interestingly, Euratex reports that "*Chinese exporters switched to more High Value Added products with much higher prices in Euros compared to previous years (+13% compared to +3% for total imports, and for ATC4 products between +4% and +37%)"*

- export value (+2,8%) and volume (+3,6%) developed positively although prices decreased slightly (-0,8%) reflecting thus the efforts of the EU industry to maintain its world market shares.

Figure 5.4.1: EU Imports & Exports of Textiles in (indexed) quantity and value

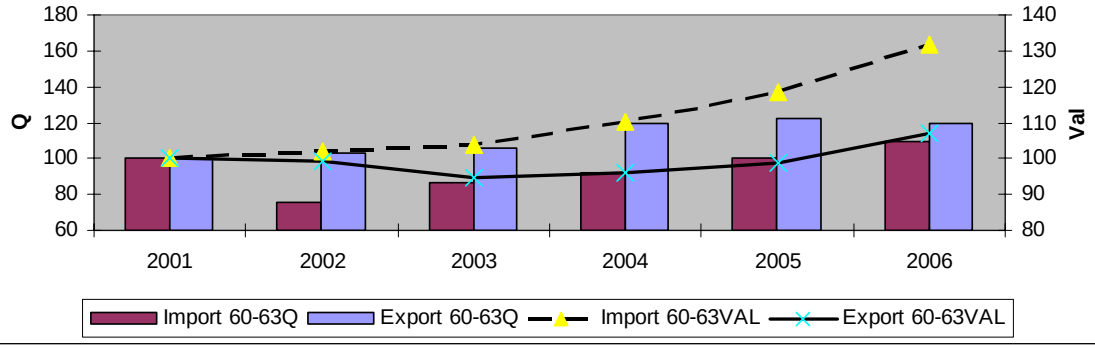


[23] Euratex General Assembly June 2007, report available in its web site

Source: EUROSTAT (COMEXT))

There is some relevance of this point also to the clothing sector, where similar trends have been noted with respect to the higher value-added items. 'Cheap competition' has thus been thwarted through skill, innovation and ingenuity (see figure 5.4.2 below).

Figure 5.4.2: EU Imports & Exports of Clothing in (indexed) quantity and value



Source: EUROSTAT (COMEXT))

From the side of imports, in 2006, we note that total imports of T&C items into the EU from the world increased substantially: from 73,1 in 2005 to €80.9 billion. This increase of 6% in quantity and 11% in value compared to 2005 was faster than that registered in 2005 (increase of 4% in quantity and 6% in value compared to 2004). However, for China, a tremendous increase in 2005 (36% in quantity and 42% in value) has been significantly lowered down in 2006 (increase of 6% in quantity and 13% in value). On this basis, the following can be noted:

– in 2005, China taking advantage of its natural competitive advantages in the context of the long announced trade liberalisation gained substantial EU market share mainly at the expense of other EU traditional sourcing countries;

– in 2006, partly due to the transitional quantitative limitations introduced for the ten most sensitive categories, and partly because the initial negative effects from the liberalisation were absorbed by the world market, the Chinese products face more competition from other developing countries better positioned in the EU market; e.g. in 2006, Bangladesh increased its exports to the EU market by 30% compared to 2005, whereas in 2005, its exports had dropped by 5% compared to the previous year. Similar trends were registered for Pakistan, Indonesian and Thai exports.

As a result of the above, account being taken of the positive (+5% in value, +2% in quantity) evolution of EU exports to the world, one would reasonably expect that a potential increase in EU imports in textiles and clothing from developing countries and LDCs is likely to compete more directly with other such countries' exports (e.g. China) rather than with EU production.

Relaxing thus EU RoO for T&C sector will mitigate the negative changes that they are likely to be subject to following the forthcoming abolition of the re-imposed quotas on China in January 2008, and provide a necessary condition for the ACP to develop a competitive clothing industry

From another perspective, the ACP share of EU imports of Textiles and clothing is small (1.19%) compared to the China region (37.82%), see Table below. Hence, even a quadrupling of the ACP exports would still mean a share of less than 5% of EU imports and reach only about 12% of the China region's share of our market, assuming that it remains constant.

Two ACP countries dominate in both HS 61-63 and in HS 50-63, Mauritius and Madagascar. The exports of Mauritius are about twice those of Madagascar. Together they account for more than 90% of all EU imports of clothing (HS 61-63) from ACP and almost 80% of EU import of Textiles and clothing (HS 50-63).

Table: EU imports of clothing (HS61-63) and Textiles and clothing (HS50-63 or Section XI) from the ACP and China region in 2006 (million euros)

HS	ACP excl. South Africa	ACP LDC	China region	Total EU imports	ACP Share (%)	ACP LDC Share (%)	China region's share
61	552	164	8.779	26.526	2.08	0.62	33.10
62	177	68	12.635	29.952	0.59	0.23	42.18
63	16	9	2.201	5.956	0.27	0.15	36.95
SUM 61-63	**745**	**241**	**23.615**	**62.434**	**1.19**	**0.39**	**37.82**
Section XI	912	339	26905	76973	1.18	0.44	34.95

Including South Africa does not alter the overall picture. For HS 61-63, EU imports from the ACP would increase 40 million. For Section XI as a whole, the increase would be 211 million.

Total imports of the ACP countries in 2006 account for 0,37% of the EU market evaluated at approximately €250 billion[24]. Hence, even a quadrupling of the ACP exports would still mean a share of 1,5% of EU market. This level of imports can hardly be of any threat for the EU industry.

Hence, a significant increase in the ACP share of EU imports of Textiles and clothing, with or without South Africa, would have a minimal impact on the EU.

[24] Based on total EU industry sales reported by Euratex, and imports and exports data from Eurostat (COMEXT)

4.4. Summary of impacts

Assessing the impact of real policies is the most effective way to examine the potential impacts of policy change on trade. The above work seeks to highlight some key issues which emerge from an analysis of existing access schemes for African LDCs.

These key points are:

- Although the EU is a key market for ACP products in general, it has not proved to be so in the clothing sector.
- One possible explanation for this fact is the EU's more restrictive RoO compared to the US and Canadian rules.
- The US have seen significant increases in imports from African LDCs since RoO were liberalised.
- Case studies in affected countries indicate that the increase in clothing trade, although associated with low levels of value added, nevertheless leads to significant positive economic and social impacts, including poverty reduction.

Real world evidence suggests that relaxed RoO, especially in the clothing sector, could have significant positive impacts on ACP countries. According to the ADE study, the current double transformation criterion corresponds to a value added criterion of about 90%. Relaxing this criterion to a level closer to what the US and Canada apply is likely to increase exports of T&C from ACP countries.

It is often argued that such liberalisation transfers the benefits of the preferential regime from the prime beneficiaries to third countries. However, the low exports of T&C from ACP countries indicate that the potential benefits of preferential access have never materialised for this region. Hence, it can be argued that, on balance, liberalisation is not against the interests of the ACPs in question, especially from the point of view of creating employment and reducing poverty.

A liberalization of RoO materialized by the single transformation criterion is likely to increase competition on the EU market for some EU industries, although very modestly. There are several factors which are considered to ease this impact:

- A potential increase in EU imports in textiles and clothing from ACP countries is likely to compete more directly with other such countries' exports (e.g. China) rather than with EU production. This is the experience from the liberalization of the market following the abolition of the quotas in 2005.
- The ACP countries are small producers of most industrial products, including textiles and clothing, and will remain marginal on the EU market even if they would manage to substantially increase their supply capacity and exports to the EU.
- EU industries that use imported inputs will gain from more liberal RoO reform due to access to cheaper inputs , while EU consumers will benefit from lower prices.
- Relaxing EU RoO for textiles and clothing will mitigate likely negative effects on developing and least developed countries' exports following the forthcoming abolition of the re-imposed quotas on China in January 2008 and the subsequent full

liberalization of the market. From another angle, it is also important to note the very significant structural and competitive problems of the ACP countries that will make it difficult for them to expand their operations in a way that could harm EU producer interests.

5. MONITORING AND EVALUATION

Rules of Origin must be used to ensure that ACP producers benefit from access to EU market. To evaluate this, a simple, quantifiable and easily monitored indicator is the export performance of the ACP exporters.

Full compatibility with relevant EU policies

- Monitoring of all aspects of implementation of liberalised RoO re T&C to check its continued with EDF policy, social and environmental matters

- Regular stakeholder consultations, including social partners and non-government organisations

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- **RISKS AND ASSUMPTIONS**

This report is based on the following risks and assumptions:

- Acceptance of analysis made available from studies commissioned by DG TRADE, TAXUD and DEV;
- acceptance of an analysis based on documentary research;
- timely availability of statistical analysis;